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E.O. 11652: N/A
TAGS: PLOS
SUBJECT: PUBLISHED RESULTS OF NG-2 ON FINANCIAL ARRANGE-
MENTS BETWEEN CONTRACTORS AND THE AUTHORITY

1. FOLLOWING ARE THE TEXTS OF THE REDRAFT OF ANNEX II,
PARAGRAPH 7 OF THE ICNT AND OF THE MEMORANDUM EXPLAINING
IT, BOTH PUBLISHED BY THE CHAIRMAN OF NEGOTIATION GROUP 2,
AMBASSADOR KOH. EVALUATION OF THESE TEXTS WILL FOLLOW.

2. BEGIN TEXT.

FINANCIAL TERMS OF CONTRACTS

THE CHAIRMAN'S SUGGESTED COMPROMISE PROPOSALS

PARAGRAPH 7, ANNEX II

IN ADOPTING RULES, REGULATIONS AND PROCEDURES
CONCERNING THE FINANCIAL TERMS OF A CONTRACT BETWEEN
THE AUTHORITY AND THE ENTITIES REFERRED TO IN SUB-
PARAGRAPH (II) OF PARAGRAPH 2 OF ARTICLE 151, AND IN
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NEGOTIATING THOSE TERMS WITHIN THE FRAMEWORK OF THE
PROVISIONS OF PART XI OF THE PRESENT CONVENTION, AND
OF THOSE RULES, REGULATIONS AND PROCEDURES, THE
AUTHORITY SHALL BE GUIDED BY THE FOLLOWING OBJECTIVES:

(A) TO ENSURE OPTIMUM REVENUES FOR THE AUTHORITY
FROM THE PROCEEDS OF COMMERCIAL EXPLOITATION;

(B) TO ATTRACT INVESTMENTS AND TECHNOLOGY TO THE
EXPLORATION AND EXPLOITATION OF THE AREA;

(C) TO ENSURE EQUALITY OF FINANCIAL TREATMENT AND
COMPARABLE FINANCIAL OBLIGATIONS ON THE PART
OF ALL STATES AND OTHER ENTITIES WHICH OBTAIN
CONTRACTS;

(D) TO PROVIDE INCENTIVES ON A UNIFORM AND NON-
DISCRIMINATORY BASIS FOR CONTRACTORS TO
UNDERTAKE JOINT ARRANGEMENTS WITH THE
ENTERPRISE AND DEVELOPING COUNTRIES OR THEIR
NATIONALS, AND TO STIMULATE THE TRANSFER OF
TECHNOLOGY THERETO; AND

(E) TO ENABLE THE ENTERPRISE TO ENGAGE IN SEA-BED
MINING EFFECTIVELY FROM THE TIME OF ENTRY INTO
FORCE OF THIS CONVENTION.

PARAGRAPH 7 (BIS)

A FEE SHALL BE LEVIED FOR THE ADMINISTRATIVE COST
OF PROCESSING IN APPLICATION FOR A CONTRACT AND SHALL
BE FIXED AT AN AMOUNT OF \$... PER APPLICATION. THE
AMOUNT OF THE FEE SHALL BE REVIEWED AT FIVE-YEARLY
INTERVALS BY THE COUNCIL IN ORDER TO ENSURE THAT IT
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COVERS THE ADMINISTRATIVE COST OF PROCESSING SUCH AN
APPLICATION.

PARAGRAPH 7 (TER)

A CONTRACTOR SHALL PAY AN ANNUAL FIXED FEE OF
\$.... FROM THE DATE OF ENTRY INTO FORCE OF THE CONTRACT.
IN LIEU OF AN ANNUAL PAYMENT, A CONTRACTOR MAY ELECT
TO PAY A LUMP SUM OF \$.... .

PARAGRAPH 7 (QUATER)

IN ADDITION TO HIS OBLIGATION UNDER PARAGRAPH 7 (TER)
A CONTRACTOR MAY CHOOSE TO MAKE HIS FINANCIAL CONTRI-
BUTIONS TO THE AUTHORITY, (A) BY PAYING A PRODUCTION
CHARGE, OR (B) BY PAYING A PRODUCTION CHARGE AND A
SHARE OF NET PROCEEDS.

PARAGRAPH 7 (QUINQUES)

(A) IF A CONTRACTOR CHOOSES TO MAKE HIS FINANCIAL
CONTRIBUTIONS TO THE AUTHORITY BY PAYING A PRODUCTION

CHARGE, IT SHALL BE FIXED AT PER CENT OF THE
MARKET VALUE OF THE PROCESSED METALS OR PERCENT
OF THE AMOUNT OF THE PROCESSED METALS PRODUCED FROM
THE NODULES EXTRACTED FROM THE CONTRACT AREA.

(B) THE SAID MARKET VALUE SHALL BE THE PRODUCT OF
THE QUANTITY OF THE PROCESSED METALS AND THE AVERAGE
PRICE FOR THOSE METALS DURING THE RELEVANT ACCOUNTING
PERIOD. IF AN INTERNATIONAL COMMODITY EXCHANGE
PROVIDES A REPRESENTATIVE PRICING MECHANISM, THE
AVERAGE PRICE ON SUCH EXCHANGE SHALL BE USED. IN
ALL OTHER CASES, THE AUTHORITY SHALL, AFTER CONSULTING
THE CONTRACTOR, DETERMINE THE AVERAGE PRICE.

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SUCH METALS SHALL BE THE PRICE FOR THE METALS IN THE
MOST BASIC FORM IN WHICH THE METALS ARE CUSTOMARILY
TRADED ON AN INTERNATIONAL MARKET.

PARAGRAPH 7 (SEXIES)

(A) IF A CONTRACTOR CHOOSES TO MAKE HIS FINANCIAL
CONTRIBUTIONS TO THE AUTHORITY BY PAYING A COMBINATION
OF A PRODUCTION CHARGE AND A SHARE OF NET PROCEEDS,
THE PRODUCTION CHARGE SHALL BE FIXED AT PER CENT
OF THE MARKET VALUE OF THE PROCESSED METALS PRODUCED
FROM THE NODULES EXTRACTED FROM THE CONTRACT AREA.
THE AUTHORITY'S SHARE OF NET PROCEEDS SHALL BE TAKEN
OUT OF AN AMOUNT EQUAL TO PER CENT OF THE

CONTRACTOR'S NET PROCEEDS TO REPRESENT THE NET PROCEEDS ATTRIBUTABLE TO MINING OF THE RESOURCES OF THE CONTRACT AREA. THIS AMOUNT SHALL BE REFERRED TO HEREINAFTER AS THE ATTRIBUTABLE NET PROCEEDS. THE AUTHORITY'S SHARE OF THE ATTRIBUTABLE NET PROCEEDS SHALL BE DETERMINED IN ACCORDANCE WITH SUB-PARAGRAPHS (B) AND (C) BELOW.

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(B) IN EACH YEAR, THE SHARE OF THE ATTRIBUTABLE NET PROCEEDS TO BE RECEIVED BY THE AUTHORITY SHALL BE DETERMINED ACCORDING TO THE RATE OF RETURN ON THE CONTRACTOR'S DEVELOPMENT COSTS. THE RATE OF RETURN ON THE CONTRACTOR'S DEVELOPMENT COSTS SHALL BE CALCULATED BY DIVIDING BY FIVE THE SUM OF THE CONTRACTOR'S PORTIONS OF NET PROCEEDS, INCLUDING HIS SHARE OF THE ATTRIBUTABLE NET PROCEEDS IN THE FIVE MOST RECENT ACCOUNTING PERIODS AND EXPRESSING THIS AVERAGE AS A PERCENTAGE OF THE TOTAL DEVELOPMENT COST AT THE END OF THAT YEAR. DURING THE INITIAL FIVE YEARS OF COMMERCIAL PRODUCTION, THIS AVERAGE SHALL BE BASED ON THE NUMBER OF YEARS FOR WHICH THE DATA ARE AVAILABLE.

(C) THE AUTHORITY'S SHARE OF THE ATTRIBUTABLE NET PROCEEDS SHALL BE DETERMINED IN ACCORDANCE WITH THE FOLLOWING SCHEDULE:

OPERATOR'S RATE OF RETURN	AUTHORITY'S PERCENTAGE
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BELOW 10 PERCENT	: PERCENT
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10 PERCENT OR MORE BUT BELOW 14 PERCENT:	PERCENT
--	---------

14 PERCENT OR MORE BUT BELOW 18 PERCENT:	PERCENT
--	---------

18 PERCENT OR MORE BUT BELOW 22 PERCENT:	PERCENT
--	---------

22 PERCENT OR MORE BUT BELOW 26 PERCENT:	PERCENT
--	---------

26 PERCENT OR MORE BUT BELOW 30 PERCENT:	PERCENT
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30 PERCENT OR MORE BUT BELOW 35 PERCENT:	PERCENT
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35 PERCENT OR MORE : PERCENT

(D) THE TERM "NET PROCEEDS" MEANS GROSS PROCEEDS LESS OPERATING COSTS AND LESS THE RECOVERY OR DEVELOPMENT COSTS AS SET OUT IN SUB-PARAGRAPH (G) BELOW.

(E) THE TERM "GROSS PROCEEDS" MEANS THE GROSS REVENUES FROM THE SALE OF THE PROCESSED METALS, RECOVERIES UNDER INSURANCE POLICIES AND ANY OTHER MONEY RECEIVED WHICH IS REASONABLY ATTRIBUTABLE TO THE OPERATIONS UNDER THE CONTRACT.

(F) THE TERM "DEVELOPMENT COSTS" MEANS:

(I) ALL EXPENDITURES INCURRED PRIOR TO THE COMMENCEMENT OF COMMERCIAL PRODUCTION WHICH ARE DIRECTLY RELATED TO THE DEVELOPMENT OF THE PRODUCTIVE CAPACITY OF THE CONTRACT AREA AND THE OPERATION RELATED THERETO, IN CONFORMITY WITH GENERALLY RECOGNIZED ACCOUNTING PRINCIPLES, INCLUDING, INTER ALIA: COSTS OF MACHINERY, EQUIPMENT, SHIPS, BUILDINGS, LAND, ROADS, PROSPECTING AND EXPLORATION OF THE CONTRACT AREA, CONSTRUCTION, INTEREST, REQUIRED LEASES, LICENSES, FEES; AND

(II) SIMILAR EXPENDITURES, INCURRED SUBSEQUENT TO THE COMMENCEMENT OF COMMERCIAL PRODUCTION, FOR THE REPLACEMENT OF EQUIPMENT AND MACHINERY.

PROCEEDS FROM THE DISPOSAL OF CAPITAL ASSETS SHALL BE DEDUCTED FROM DEVELOPMENT COSTS DURING THE ACCOUNTING

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PERIOD IN WHICH THEY WERE RECEIVED.

(G) THE DEVELOPMENT COSTS REFERRED TO IN SUB-PARAGRAPH (F)(I) ABOVE SHALL BE RECOVERED IN 10 EQUAL ANNUAL INSTALLMENTS FROM THE DATE OF COMMENCEMENT OF COMMERCIAL PRODUCTION. THE DEVELOPMENT COSTS REFERRED TO IN SUB-PARAGRAPH (F)(II) ABOVE SHALL BE RECOVERED IN 10 OR FEWER EQUAL ANNUAL INSTALLMENTS SO AS TO ENSURE THEIR COMPLETE RECOVERY BY THE END OF THE CONTRACT.

(H) THE TERM "OPERATING COSTS" MEANS ALL EXPENDITURES INCURRED IN THE OPERATION OF THE PRODUCTIVE CAPACITY OF THE CONTRACT AREA AND THE OPERATION RELATED THERETO, IN CONFORMITY WITH GENERALLY RECOGNIZED ACCOUNTING PRINCIPLES, INCLUDING, INTER ALIA, THE FIXED ANNUAL FEE, THE PRODUCTION CHARGE, EXPENDITURES FROM WAGES, SALARIES, EMPLOYEE BENEFITS, SUPPLIES, MATERIALS, SERVICES, TRANSPORTATION, MARKETING COSTS, INTEREST, UTILITIES, PRESERVATION OF THE MARINE ENVIRONMENT, OVERHEAD AND ADMINISTRATIVE COSTS SPECIFICALLY RELATED TO THE OPERATIONS OF THE CONTRACT
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AREA AND ANY NET OPERATING LOSSES CARRIED FORWARD FROM PRIOR ACCOUNTING PERIODS.

(I) THE COSTS REFERRED TO IN SUB-PARAGRAPHS (F) AND (H) ABOVE IN RESPECT OF INTEREST PAID BY THE CONTRACTOR MAY ONLY BE ALLOWED IF, IN ALL THE CIRCUMSTANCES, THE AUTHORITY APPROVES, PURSUANT TO PARA 4(A) OF ANNEX II, THE DEBT-EQUITY RATIO AND THE RATES OF INTEREST AS REASONABLE, HAVING REGARD TO EXISTING COMMERCIAL RATES.

(J) (I) ALL COSTS AND REVENUES REFERRED TO IN THIS PARAGRAPH SHALL BE THE RESULT OF

FREE MARKET OR ARM'S LENGTH TRANSACTIONS;

(II) IF THE COSTS AND REVENUES ARE NOT THE RESULT OF FREE MARKET OR ARM'S LENGTH TRANSACTIONS, THEY SHALL BE COMPUTED BY THE AUTHORITY AS THOUGH THEY TOOK PLACE AT ARM'S LENGTH OR WERE THE RESULT OF FREE MARKET TRANSACTIONS;

(III) IN DETERMINING THE VALUE OF ANY ARM'S LENGTH TRANSACTIONS OR FREE MARKET TRANSACTIONS, THE AUTHORITY SHALL USE THE VALUE OF A SIMILAR TRANSACTION TAKING PLACE IN OTHER MARKETS WHERE FREE MARKET FORCES OR ARM'S LENGTH TRANSACTIONS HAVE PREVAILED;

(IV) IN ORDER TO ENSURE THAT ALL COSTS AND REVENUES ARE THE RESULT OF FREE MARKET TRANSACTIONS OR TAKE PLACE AT ARM'S

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LENGTH AND TO ENSURE ENFORCEMENT OF AND COMPLIANCE WITH THE PROVISIONS OF THIS SUB-PARAGRAPH, THE AUTHORITY SHALL ADOPT RULES AND REGULATIONS SPECIFYING UNIFORM AND GENERALLY ACCEPTABLE ACCOUNTING RULES AND PROCEDURES TO BE FOLLOWED BY THE CONTRACTOR AND THE MEANS OF SELECTION BY THE CONTRACTOR OF CERTIFIED INDEPENDENT ACCOUNTANTS ACCEPTABLE TO THE AUTHORITY FOR THE PURPOSE OF AUDITING IN COMPLIANCE WITH SAID RULES AND REGULATIONS; AND

(V) THE CONTRACTOR SHALL MAKE AVAILABLE TO THE ACCOUNTANTS, IN ACCORDANCE WITH THE FINANCIAL RULES AND REGULATIONS OF THE AUTHORITY, SUCH FINANCIAL DATA AS ARE REQUIRED TO DETERMINE COMPLIANCE WITH THIS PARAGRAPH.

(K) THE COSTS REFERRED TO ABOVE SHALL NOT BE INTERPRETED AS INCLUDING PAYMENTS IN RESPECT OF CORPORATE INCOME TAXES OR SIMILAR CHARGES LEVIED BY STATES IN RESPECT OF THE OPERATIONS OF THE CONTRACTOR.

PARAGRAPH 7 (SEPTIES)

THE AUTHORITY MAY, TAKING INTO ACCOUNT ANY RECOMMENDATIONS OF THE ECONOMIC PLANNING COMMISSION AND THE

TECHNICAL COMMISSION, ADOPT RULES AND REGULATIONS THAT PROVIDE FOR INCENTIVES, ON A UNIFORM AND NON-DISCRIMINATORY BASIS, TO CONTRACTORS TO FURTHER THE OBJECTIVES SET OUT IN PARAGRAPH 7 ABOVE.

PARAGRAPH 7 (OCTIES)

IN THE EVENT OF A DISPUTE BETWEEN THE AUTHORITY AND

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AN OPERATOR OVER THE FINANCIAL TERMS OF A CONTRACT,
EITHER PARTY MAY REQUEST RESOLUTION OF THE DISPUTE
THROUGH COMPULSORY AND BINDING COMMERCIAL ARBITRATION.

PARAGRAPH 7 (NOVIES)

THE PAYMENTS TO THE AUTHORITY UNDER PARAGRAPHS 7
(QUINQUIES) AND (SEXIES) ABOVE MAY BE MADE EITHER IN
A FREELY CONVERTIBLE CURRENCY OR IN A CURRENCY AGREED
UPON BETWEEN THE AUTHORITY AND THE CONTRACTOR, OR IN
THE EQUIVALENTS OF PROCESSED METALS AT CURRENT MARKET
VALUE. THE MARKET VALUE SHALL BE ASCERTAINED IN
ACCORDANCE WITH SUB-PARAGRAPH (B) OF PARAGRAPH 7
(QUINQUIES) ABOVE.

FINANCIAL TERMS OF CONTRACTS

THE CHAIRMAN'S EXPLANATORY MEMORANDUM ON DOCUMENT NG2/7

1. DO THE FINANCIAL TERMS OF CONTRACTS APPLY TO THE
ENTERPRISE?

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SEVERAL INDUSTRIALIZED COUNTRIES HAVE RAISED THE POINT THAT PLANS OF WORK OF THE ENTERPRISE SHOULD CONTAIN THE SAME FINANCIAL TERMS AS CONTRACTS OF EXPLORATION AND EXPLOITATION. THEY HAVE THEREFORE SUGGESTED THAT WHEREVER THE TERM "CONTRACTS" IS USED, IT SHOULD BE REPLACED BY THE TERM "PLANS OF WORK". I HAVE NOT DONE SO BECAUSE THE QUESTION FALLS OUTSIDE THE TERMS OF REFERENCE OF NEGOTIATING GROUP NO. 2. THE QUESTIONS WHETHER THE SAME FINANCIAL TERMS SHOULD APPLY TO THE ENTERPRISE AND IF NOT, WHAT OTHER FINANCIAL TERMS SHOULD APPLY, SHOULD HOWEVER BE DISCUSSED BY THE FIRST COMMITTEE.

2. THE OBJECTIVES IN PARAGRAPH 7

PARAGRAPH 7(A) OF ANNEX II OF THE ICNT SETS OUT FIVE OBJECTIVES WHICH SHOULD GUIDE THE AUTHORITY IN ADOPTING RULES, REGULATIONS AND PROCEDURES CONCERNING THE FINANCIAL TERMS OF CONTRACTS AND IN NEGOTIATING THOSE TERMS. I HAVE REPRODUCED THE FIVE OBJECTIVES IN MY REDRAFT OF PARAGRAPH 7. THE FIRST THREE OF THE FIVE OBJECTIVES SEEM TO BE ACCEPTABLE TO ALL DELEGATIONS. SOME INDUSTRIALIZED COUNTRIES HAVE, HOWEVER, OBJECTED TO THE FOURTH AND FIFTH OBJECTIVES AND HAVE ASKED FOR THEIR DELETION. I HAVE RETAINED THE FOURTH AND FIFTH OBJECTIVES BECAUSE I CONSIDER THEM PART OF THE PACKAGE OFFERED BY THE DEVELOPED COUNTRIES TO THE DEVELOPING COUNTRIES FOR THE ACCEPTANCE OF THE PARALLEL SYSTEM OF EXPLORATION AND EXPLOITATION.

3. IS IT POSSIBLE TO NEGOTIATE THE FINANCIAL TERMS NOW?

IN THE NEGOTIATING GROUP TWO DIFFERENT VIEWS WERE
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EXPRESSED ON THE QUESTION WHETHER IT IS POSSIBLE FOR US TO NEGOTIATE THE FINANCIAL TERMS OF CONTRACTS NOW. THE FIRST VIEW WAS THAT IT IS NOT POSSIBLE TO HOLD A MEANINGFUL NEGOTIATION NOW ON THE FINANCIAL TERMS OF CONTRACTS. IT WAS POINTED OUT THAT WE ARE TRYING TO WRITE THE DETAILED FINANCIAL TERMS OF CONTRACTS OF AN INDUSTRY WHICH DOES NOT NOW EXIST. IT WAS POINTED OUT THAT THE VARIOUS ASSUMPTIONS ABOUT THE

DEVELOPMENT COSTS OF A MINING PROJECT, ABOUT ANNUAL OPERATING COSTS, ABOUT GROSS PROCEEDS, ABOUT NET PROCEEDS, MAY TURN OUT TO BE FALSE IN PRACTICE. THE TREMENDOUS COST OVERRUNS OF THE ALASKA PIPELINE PROJECT AND THE NORTH SEA OIL EXPLORATION WERE REFERRED TO IN THIS CONNEXION. THOSE WHO HELD THE FIRST POINT OF VIEW THEREFORE ARGUED THAT PARAGRAPH 7 OF ANNEX II SHOULD ONLY CONTAIN A FRAMEWORK OF PRINCIPLES AND OBJECTIVE CRITERIA WHICH WILL GOVERN SUBSEQUENT NEGOTIATIONS ON FINANCIAL TERMS BETWEEN THE AUTHORITY AND APPLICANTS FOR CONTRACT.

THE SECOND POINT OF VIEW WAS THAT ALTHOUGH THE TASK IS DIFFICULT, IT IS NOT IMPOSSIBLE TO NEGOTIATE THE FINANCIAL TERMS OF CONTRACTS NOW. THE NEGOTIATING GROUP AGREED TO TRY THE SECOND APPROACH AND FOR THIS PURPOSE, ESTABLISHED AN OPEN-ENDED GROUP OF FINANCIAL EXPERTS.

4. THE DATA PROBLEM

IN THE GROUP OF FINANCIAL EXPERTS WE WERE IMMEDIATELY CONFRONTED WITH THE NEED TO AGREE ON A SET OF ASSUMPTIONS. WITHOUT AN AGREED FRAMEWORK OF ASSUMPTIONS IT WOULD NOT HAVE BEEN POSSIBLE FOR US TO CARRY ON WITH OUR DISCUSSIONS. WE AGREED THAT THE BEST STUDY TO DATE WAS THAT UNDERTAKEN BY THE MASSACHUSETTS INSTITUTE OF

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TECHNOLOGY, ENTITLED, "A COST MODEL OF DEEP OCEAN

MINING AND ASSOCIATED REGULATORY ISSUES", HEREINAFTER REFERRED TO AS THE MIT STUDY.

THE MIT STUDY ESTIMATES THE TOTAL DEVELOPMENT COSTS OF A MINING PROJECT AT \$559 MILLION, THE ANNUAL OPERATING COSTS AT \$100 MILLION AND THE ANNUAL GROSS PROCEEDS AT \$258 MILLION.

ALTHOUGH ALL DELEGATES AGREED THAT THE MIT STUDY APPEARS TO BE A VERY GOOD STUDY, SOME DELEGATES QUESTIONED SOME OF ITS ASSUMPTIONS. FOR EXAMPLE, THE ESTIMATED ANNUAL GROSS PROCEEDS OF \$258 MILLION IS BASED UPON THE ASSUMPTION THAT NODULES WILL HAVE AN AVERAGE METAL CONTENT OF 2.8 PER CENT. SEVERAL DELEGATIONS POINTED OUT THAT MORE RECENT STUDIES SUGGEST THAT THE AVERAGE METAL CONTENT OF NODULES IS ABOUT 2.4 PER CENT NOT 2.8 PER CENT. ON THE OTHER HAND, IF METAL PRICES GO UP FROM THEIR PRESENT DEPRESSED LEVELS, THIS WILL BOOST THE ESTIMATED GROSS PROCEEDS. THE POINT I WISH TO MAKE HERE IS THAT WE HAVE HAD TO MAKE MANY ASSUMPTIONS ABOUT COSTS AND REVENUES

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AND THAT REALITY MAY LOOK VERY DIFFERENT FROM OUR ASSUMPTIONS.

5. THE APPLICATION FEE

IT IS AGREED BY ALL THAT AN APPLICANT FOR A CONTRACT SHOULD PAY AN APPLICATION FEE. IT IS ALSO AGREED THAT THE FEE SHOULD COVER THE COST OF PROCESSING SUCH AN APPLICATION AND THAT THE AMOUNT BE REVIEWED EVERY FIVE YEARS. WE ARE, HOWEVER, UNABLE TO AGREE ON WHAT THE AMOUNT SHOULD BE IN THE FIRST INSTANCE. SOME SAY IT SHOULD BE \$100,000. OTHERS SAY IT SHOULD BE \$500,000. MY SUGGESTION OF \$250,000 DOES NOT SEEM TO HAVE BEEN WELL RECEIVED BY THE TWO SIDES. CONSEQUENTLY, I HAVE LEFT THE AMOUNT BLANK IN PARAGRAPH 7(BIS).

6. THE ANNUAL FIXED CHARGE TO MINE OR BONUS PAYMENT

PARAGRAPH 7(D)(I) OF ANNEX II OF THE ICNT PROPOSES AN ANNUAL FIXED CHARGE TO MINE. SOME DELEGATIONS HAVE ARGUED THAT THE ANNUAL FIXED CHARGE TO MINE IS TO DETER A CONTRACTOR FROM SITTING ON HIS MINE SITE WITHOUT COMMENCING OPERATIONS AFTER THREE YEARS. MEMBERS OF THE GROUP OF 77 SAID THAT THE PURPOSE OF THE ANNUAL FIXED CHARGE IS NOT MERELY DETERRENT. IT IS ALSO A SOURCE OF REVENUE FOR THE AUTHORITY PAYABLE AT THE

FRONT-END OF THE OPERATION. IT IS A PAYMENT THE CONTRACTOR MUST MAKE FOR HIS RIGHT TO MINE. INSTEAD OF AN ANNUAL PAYMENT, THE DELEGATION OF INDIA PROPOSED A LUMP SUM OF \$60 MILLION.

THE INDUSTRIALIZED COUNTRIES ARE OPPOSED TO THE UNCLASSIFIED

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PROPOSAL OF INDIA. THEY ALSO OPPOSE THE FIXED ANNUAL CHARGE TO MINE FOR TWO REASONS. FIRST, THEY ARGUE THAT IT IS NOT NECESSARY TO HAVE A DETERRENT AGAINST DELAY BECAUSE THE CONTRACTOR HAS VERY STRONG INCENTIVES TO COMMENCE HIS PRODUCTION AS SOON AS POSSIBLE. SECONDLY, THEY OPPOSE IT BECAUSE IT INCREASES THE FRONT-END BURDEN ON THE CONTRACTOR. THE SOVIET UNION ARGUED THAT SINCE A STATE PARTY IS A PART OF MANKIND, IT THEREFORE HAS AN INHERENT RIGHT TO MINE THE RESOURCES OF THE AREA, AND SHOULD NOT BE ASKED TO PAY FOR THAT RIGHT.

MY PROPOSAL IS CONTAINED IN PARAGRAPH 7(TER). I PROPOSE THAT A CONTRACTOR SHOULD PAY AN "ANNUAL FIXED FEE" OF AN AMOUNT TO BE NEGOTIATED. THE FEE IS PAYABLE FROM THE COMMENCEMENT OF THE CONTRACT. THIS WILL ENSURE THAT THE AUTHORITY WILL RECEIVE SOME REVENUES EVEN BEFORE THE COMMENCEMENT OF COMMERCIAL PRODUCTION. IN ORDER TO AVOID CONCEPTUAL PROBLEMS, I HAVE CHANGED THE NAME FROM "ANNUAL FIXED CHARGE TO MINE" TO "ANNUAL FIXED FEE". IN LIEU OF AN ANNUAL PAYMENT, A CONTRACTOR MAY CHOOSE TO PAY THE AUTHORITY, AT THE SIGNING OF THE CONTRACT, A LUMP SUM THE AMOUNT OF WHICH IS TO BE NEGOTIATED. THE ANNUAL FIXED FEE IS DEDUCTIBLE AS A DEVELOPMENT COST, IF INCURRED BEFORE THE COMMENCEMENT OF PRODUCTION, AND FROM THE OPERATING COST, IF INCURRED AFTER THE COMMENCEMENT OF PRODUCTION.

7. ONE SYSTEM OR TWO SYSTEMS OF FINANCIAL PAYMENTS?

IN ADDITION TO THE FIXED ANNUAL FEE, THE CONTRACTOR MUST MAKE FINANCIAL PAYMENTS TO THE AUTHORITY. SHOULD THERE BE A SINGLE SYSTEM OF FINANCIAL PAYMENTS ONLY? I HAVE COME TO THE CONCLUSION THAT WE NEED MORE THAN ONE SYSTEM OF FINANCIAL PAYMENTS. THE SOVIET UNION, AS

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WELL AS SOME OTHER DEVELOPED AND DEVELOPING COUNTRIES,
PREFER THE SYSTEM OF PRODUCTION CHARGE. THE UNITED
STATES, THE EEC AND JAPAN CANNOT ACCEPT A SINGLE
SYSTEM OF PRODUCTION CHARGE. THEY WOULD PREFER THE
CONTRACTOR TO MAKE HIS FINANCIAL PAYMENTS TO THE
AUTHORITY BY WAY OF A MIXTURE OF PRODUCTION CHARGE
AND SHARE OF NET PROCEEDS.

IN PARAGRAPH 2 (QUATER) HAVE THEREFORE PROPOSED
TWO SYSTEMS OF PAYMENTS. THE FIRST IS BY WAY OF THE
PRODUCTION CHARGE ALONE. THE SECOND IS BY A COMBI-
NATION OF THE PRODUCTION CHARGE AND SHARE OF NET
PROCEEDS. I HAVE GIVEN THE CHOICE TO THE CONTRACTOR.
ONE DELEGATION HAS SUGGESTED THAT THE CHOICE SHOULD
LIE WITH THE AUTHORITY. I FEEL THAT THE CHOICE SHOULD
BE WITH THE CONTRACTOR BECAUSE HE SHOULD CHOOSE THE
SYSTEM OF PAYMENT WHICH IS MOST COMPATIBLE WITH THE
SOCIAL AND ECONOMIC SYSTEM TO WHICH HE BELONGS. AS
LONG AS THE TWO SYSTEMS OF PAYMENTS ARE OF EQUAL
ADVANTAGE TO THE AUTHORITY, IT DOES NOT REALLY MATTER
WHICH ONE THE CONTRACTOR CHOOSES.

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8. THE PRODUCTION CHARGE SYSTEM OF PAYMENT

PARAGRAPH 7 (QUINQUIES) PROVIDES FOR THE FIRST
SYSTEM OF PAYMENT. THE CONTRACTOR SHALL PAY TO THE
AUTHORITY A SUM EQUAL TO THE MARKET VALUE OF A
CERTAIN PERCENTAGE OF THE PROCESSED METALS PRODUCED
FROM THE NODULES EXTRACTED FROM THE CONTRACT AREA.

THE CONTRACTOR MAY ALTERNATIVELY PAY THE AUTHORITY IN KIND I.E. BY GIVING THE AUTHORITY A CERTAIN PERCENTAGE OF THE AMOUNT OF THE PROCESSED METALS PRODUCED FROM THE NODULES EXTRACTED FROM THE CONTRACT AREA. WHY HAVE I GIVEN THIS ALTERNATIVE TO THE CONTRACTOR? I HAVE DONE SO IN ORDER TO ACCOMMODATE THOSE STATES WHOSE CURRENCIES ARE NOT FREELY CONVERTIBLE.

THE PRODUCTION CHARGE SYSTEM OF PAYMENT HAS SEVERAL MERITS. FIRST, IT IS A CONSTANT PAYMENT OF A FIXED AMOUNT FROM THE TIME OF COMMENCEMENT OF PRODUCTION AND WOULD BE ESPECIALLY HELPFUL TO THE AUTHORITY IN THE EARLIER YEARS. SECOND, IT ASSURES THE AUTHORITY OF REVENUES IRRESPECTIVE OF THE PROFITABILITY OF THE CONTRACTOR'S PROJECT. THIRD, IT FREES THE AUTHORITY OF THE NECESSITY TO VERIFY THE ACCOUNTS OF THE CONTRACTOR. FOURTH, IT DOES AWAY WITH THE TROUBLE-SOME QUESTION WHAT PERCENTAGE OF THE CONTRACTOR'S GROSS PROCEEDS OR NET PROCEEDS IS ATTRIBUTABLE TO THE MINING OF THE RESOURCES OF THE CONTRACT AREA.

DOES THIS SYSTEM HAVE ANY SHORTCOMINGS? IT HAS AT LEAST TWO DISADVANTAGES. FIRST, THE HEAVY OBLIGATIONS MAY BE DIFFICULT IF NOT IMPOSSIBLE FOR SOME CONTRACTORS TO BEAR AT THE OUTSET OF THEIR COMMERCIAL UNCLASSIFIED

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PRODUCTION. SECOND, UNDER THIS SYSTEM, THE REVENUES TO THE AUTHORITY DO NOT VARY WITH THE PROFITABILITY OF THE CONTRACTOR'S OPERATIONS.

9. THE PROPOSALS OF USSR AND NORWAY

THE USSR MADE A SPECIFIC PROPOSAL UNDER THE PRODUCTION CHARGE SYSTEM OF PAYMENT. IT OFFERED TO PAY 7.5 PERCENT OF THE MARKET VALUE OF THE PROCESSED METALS. ASSUMING THAT GROSS PROCEEDS ARE \$260 MILLION PER ANNUM, THE SOVIET OFFER WOULD GIVE THE AUTHORITY AN INCOME OF \$19.5 MILLION PER ANNUM OR A TOTAL OF \$390 MILLION OVER A PERIOD OF 20 YEARS.

THE NORWEGIAN DELEGATION PROPOSED THAT UNDER THIS SYSTEM, A CONTRACTOR SHOULD PAY AT 8 PER CENT OF THE MARKET VALUE OF PROCESSED METALS DURING THE FIRST FIVE YEARS AND AT 16 PER CENT DURING THE NEXT FIFTEEN YEARS. UNDER THE NORWEGIAN PROPOSAL THE AUTHORITY WOULD RECEIVE \$104 MILLION DURING THE FIRST FIVE YEARS AND \$624 MILLION DURING THE NEXT FIFTEEN YEARS, MAKING A TOTAL OF \$728 MILLION OVER A PERIOD OF 20 YEARS.

10. THE SECOND SYSTEM OF PAYMENT

THE SECOND SYSTEM OF PAYMENT IS A COMBINATION OF THE PRODUCTION CHARGE AND A SHARE OF NET PROCEEDS. THIS SYSTEM OF PAYMENT IS SET OUT IN PARAGRAPH 7 (SEXIES) AND WAS EMBODIED IN THE ICNT. IT IS A SYSTEM THAT REFLECTS A COMPROMISE BETWEEN THOSE DELEGATES WHO WANTED A SYSTEM OF PRODUCTION CHARGE AS THE SOLE MAJOR SYSTEM OF PAYMENTS TO THE AUTHORITY AND THOSE WHO WANTED A SHARE OF NET PROCEEDS AS THE SOLE MAJOR SYSTEM OF PAYMENTS TO THE AUTHORITY.

WHAT ARE THE ADVANTAGES OF THIS COMBINED SYSTEM
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OVER THE FIRST SYSTEM? THERE ARE SEVERAL ADVANTAGES. FIRST, IT PLACES LESS BURDEN ON THE FRONT-END THAN THE FIRST SYSTEM DOES. SECOND, IF THE CONTRACTOR PROSPERS, THE AUTHORITY SHARES HIS PROSPERITY. THE AUTHORITY'S REVENUES RISE WITH THE RISING LEVEL OF THE CONTRACTOR'S PROFITABILITY.

DOES THIS SYSTEM HAVE ANY DISADVANTAGES COMPARED WITH THE FIRST SYSTEM? IT DOES. FIRST, IT IS MUCH MORE COMPLICATED THAN THE OTHER SYSTEM AND IS MORE DIFFICULT TO ADMINISTER. SECOND, THE BACK-END PAYMENT TO THE AUTHORITY IS NOT ASSURED. IF THE CONTRACTOR DOES POORLY, THE AUTHORITY DOES POORLY TOO.

UNDER SUB-PARAGRAPH (A) OF PARAGRAPH 7 (SEXIES), THE CONTRACTOR SHALL PAY A PERCENTAGE OF THE MARKET VALUE OF THE PROCESSED METALS. THE PERCENTAGE IS BLANK IN THE TEXT. IN ADDITION, THE CONTRACTOR MUST PAY A CERTAIN PORTION OF HIS NET PROCEEDS TO THE AUTHORITY. HOW IS THIS TO BE DETERMINED?

TO DO SO, WE BEGIN WITH THE CONTRACTOR'S GROSS
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PROCEEDS. HIS GROSS PROCEEDS WILL COME MAINLY FROM THE SALE OF THE PROCESSED METALS. ACCORDING TO THE M.I.T. STUDY, HIS GROSS PROCEEDS PER ANNUM WILL BE AROUND \$260 MILLION. WE THEN DEDUCT FROM THE CONTRACTOR'S GROSS PROCEEDS HIS OPERATING COSTS. ACCORDING TO THE M.I.T. STUDY, HIS OPERATING COSTS PER ANNUM WILL BE AROUND \$100 MILLION. THIS GIVES US A REMAINDER OF \$160 MILLION. NEXT, WE DEDUCT ONE-TENTH OF HIS DEVELOPMENT COSTS.

THE REASONS WHY I HAVE CHOSEN A 10-YEAR PERIOD FOR THE RECOVERY OF HIS DEVELOPMENT COSTS IS THAT IT IS A COMPROMISE BETWEEN SEVERAL PROPOSALS THAT WERE MADE. THESE VARIED FROM A RECOVERY PERIOD OVER THE WHOLE PERIOD OF THE CONTRACT TO ONE AS SHORT AS FIVE YEARS. THIS LATTER SUGGESTION WOULD, OF COURSE, LEAVE LITTLE, IF ANY, PROFITS FOR SHARING WITH THE AUTHORITY DURING THAT FIRST FIVE YEARS, BUT IT WOULD CERTAINLY GIVE THE CONTRACTOR AN ENHANCED PROFITABILITY. I FEEL THAT THIS COMPROMISE PROPOSAL FOR A RECOVERY OVER 10 YEARS IS REASONABLE IN THE LIGHT OF THE LIFE OF THE EQUIPMENT AND THE TREATMENT OF MAINTENANCE COSTS AS A DEVELOPMENT COST AND THIS IS IN LINE WITH COMMERCIAL PRACTICE.

ACCORDING TO THE M.I.T. STUDY, THE CONTRACTOR'S DEVELOPMENT COSTS ARE ABOUT \$560 MILLION. ONE-TENTH OF THIS IS \$56 MILLION. IF WE SUBTRACT \$56 MILLION FROM \$160 MILLION, WE ARE LEFT WITH \$104 MILLION. THIS AMOUNT IS CALLED THE CONTRACTOR'S NET PROCEEDS.

AT THIS POINT, WE CONFRONT A DIFFICULT ISSUE. ACCORDING TO SOME DELEGATIONS, THE AUTHORITY IS

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ENTITLED TO A SHARE OF THE CONTRACTOR'S TOTAL NET PROCEEDS. OTHER DELEGATIONS, HOWEVER, HOLD A DIFFERENT VIEW. THEY SAID THAT THE CONTRACTOR'S NET PROCEEDS ARE DERIVED FROM MINING THE NODULES, FROM TRANSPORTING THEM, FROM PROCESSING AND MARKETING THEM. THEY STATED THAT TRANSPORTATION, PROCESSING AND MARKETING ARE ACTIVITIES SUBJECT TO NATIONAL JURISDICTION AND TO NATIONAL TAXATION. THEY ARGUED THAT THE AUTHORITY HAS NO RIGHT TO TAX THE PROFITS DERIVED FROM PROCESSING AND MARKETING. THEREFORE, IT IS ARGUED THAT IT IS NECESSARY TO APPORTION A PART OF THE CONTRACTOR'S TOTAL NET PROCEEDS WHICH IS ATTRIBUTABLE TO MINING OF THE RESOURCES OF THE CONTRACT AREA. I HAVE CALLED THIS PORTION OF THE CONTRACTOR'S NET PROCEEDS THE "ATTRIBUTABLE NET PROCEEDS".

WHAT PERCENTAGE OF THE NET PROCEEDS SHOULD CONSTITUTE THE ATTRIBUTABLE NET PROCEEDS? OPINIONS DIFFERED GREATLY, RANGING FROM 20 PER CENT TO 100 PER CENT. IS THERE ANY RATIONAL OR OBJECTIVE WAY IN WHICH THIS QUESTION CAN BE RESOLVED? SOME DELEGATIONS ARGUED THAT THE PERCENTAGE SHOULD BE DETERMINED BY THE RATIO BETWEEN THE CAPITAL INVESTED IN THE MINING STAGE AND THE CAPITAL INVESTED IN THE OTHER STAGES. OTHER DELEGATIONS OBJECTED TO THIS APPROACH ON THE GROUND THAT IT ASSIGNS NO VALUE OR AN INADEQUATE VALUE TO THE NODULES. IN THE ABSENCE OF ANY AGREED CRITERION FOR DIVIDING NET PROCEEDS BETWEEN THE MINING SECTOR AND THE OTHER SECTORS IT BECOMES A QUESTION TO BE SETTLED BY NEGOTIATION. IN SUB-PARAGRAPH (A) OF PARAGRAPH 7 (SEXIES) I HAVE LEFT THE PERCENTAGE BLANK.

THE AUTHORITY'S SHARE OF THE ATTRIBUTABLE NET PROCEEDS SHALL BE DETERMINED IN ACCORDANCE WITH SUB-PARAGRAPHS (B) AND (C) OF PARAGRAPH 7 (SEXIES). THE SCHEME IS SIMILAR TO WHAT IN NATIONAL LAW IS CALLED

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PROGRESSIVE TAXATION. THE AUTHORITY'S SHARE OF THE
ATTRIBUTABLE NET PROCEEDS DEPENDS UPON THE CONTRACTOR'S
RATE OF RETURN ON HIS INVESTMENT. THE HIGHER THE
CONTRACTOR'S RATE OF RETURN ON INVESTMENT, THE HIGHER
THE AUTHORITY'S PERCENTAGE OF THE ATTRIBUTABLE
NET PROCEEDS. IN SUB-PARAGRAPH (C) I HAVE SET OUT
EIGHT STEPS OF PROFITABILITY AND I HAVE LEFT BLANK
THE AUTHORITY'S PERCENTAGE IN RESPECT OF EACH STEP.

11. THE DIFFERENT PROPOSALS MONETISED

PROPOSALS WERE RECEIVED, UNDER THE SECOND SYSTEM
OF PAYMENT, FROM INDIA, THE UNITED STATES OF AMERICA,
EEC, NORWAY AND JAPAN. INDIA PROPOSED A PRODUCTION
CHARGE OF 10 PER CENT OF GROSS PROCEEDS TOGETHER WITH
50 PER CENT OF NET PROCEEDS. AFTER THE CONTRACTOR
HAS RECOVERED 200 PER CENT OF HIS DEVELOPMENT COSTS,
THE AUTHORITY'S SHARE OF NET PROCEEDS IS INCREASED
TO 60 PER CENT. OVER A PERIOD OF 20 YEARS THE
AUTHORITY WILL RECEIVE A TOTAL OF \$1,600 MILLION
FROM THE CONTRACTOR.

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THE DELEGATION OF NORWAY PROPOSED THAT THE
CONTRACTOR SHALL PAY A PRODUCTION CHARGE OF 3 PER CENT
DURING THE FIRST 10 YEARS AND 5 PER CENT DURING THE
NEXT 10 YEARS, TOGETHER WITH 50 PER CENT OF THE
ATTRIBUTABLE NET PROCEEDS DURING THE FIRST 10 YEARS

AND 80 PER CENT DURING THE FOLLOWING 10 YEARS.
ATTRIBUTABLE PROCEEDS SHALL BE 50 PER CENT OF TOTAL
NET PROCEEDS. OVER A PERIOD OF 20 YEARS THE AUTHORITY
WILL RECEIVE A TOTAL OF \$1,050 MILLION FROM THE CON-
TRACTOR.

THE DELEGATION OF THE UNITED STATES PROPOSED THAT
THE CONTRACTOR SHALL PAY A PRODUCTION CHARGE OF 2
PER CENT AND 30 PER CENT OF ATTRIBUTABLE NET PROCEEDS
IF THE RATE OF RETURN IS BETWEEN 0 AND 7 PER CENT,
AND 60 PER CENT OF ATTRIBUTABLE NET PROCEEDS IF THE
RATE OF RETURN IS BETWEEN 7 AND 20 PER CENT AND 75
PER CENT OF THE ATTRIBUTABLE NET PROCEEDS IF THE RATE
OF RETURN IS OVER 20 PER CENT. UNDER THE UNITED STATES
PROPOSAL, THE ATTRIBUTABLE NET PROCEEDS ARE 20 PER CENT
OF TOTAL NET PROCEEDS. OVER A PERIOD OF 20 YEARS,
THE AUTHORITY, UNDER NORMAL PROFIT CONDITIONS, WILL
RECEIVE \$335 MILLION FROM THE CONTRACTOR. UNDER HIGH
PROFIT CONDITIONS, THE AUTHORITY WILL RECEIVE \$372
MILLION.

THE JAPANESE DELEGATION PROPOSED A PRODUCTION
CHARGE OF 0.75 PER CENT TOGETHER WITH 25 PER CENT OF
ATTRIBUTABLE NET PROCEEDS DURING THE FIRST 10 YEARS
AND 50 PER CENT OF ATTRIBUTABLE NET PROCEEDS DURING
THE FOLLOWING 10 YEARS. ATTRIBUTABLE NET PROCEEDS
IS DEFINED AS 20 PER CENT OF TOTAL NET PROCEEDS.
UNDER THE JAPANESE PROPOSAL THE AUTHORITY WILL
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RECEIVE A TOTAL INCOME OF \$240 MILLION OVER 20 YEARS
UNDER NORMAL CONDITIONS OF PROFITABILITY.

THE EEC PROPOSED A PRODUCTION CHARGE OF 0.75
PER CENT TOGETHER WITH A SHARE OF ATTRIBUTABLE NET
PROCEEDS WHICH VARIES DEPENDING UPON THE CONTRACTOR'S
RATE OF RETURN. THE EEC HAS PROPOSED SEVEN LEVELS
OF PROFITABILITY RANGING FROM 10 TO 30 PER CENT.
THE AUTHORITY'S SHARE WILL RANGE FROM 10 TO 58
PER CENT. UNDER THE EEC'S PROPOSAL, ATTRIBUTABLE NET
PROCEEDS ARE 20 PER CENT OF TOTAL NET PROCEEDS.
UNDER NORMAL CONDITIONS OF PROFITABILITY THE AUTHORITY
WILL RECEIVE \$151 MILLION. UNDER CONDITIONS OF HIGH
PROFITABILITY THE AUTHORITY'S INCOME WILL INCREASE
TO \$315 MILLION. UNDER CONDITIONS OF LOW PROFITA-
BILITY, THE AUTHORIT'S INCOME WILL BE \$75 MILLION.
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